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State Taxation of Federal Instrumentalities--Federal Taxation of State Instrumentalities

Julius Leventhal

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in the *Schlesinger* case, "the classification of gifts was deemed to be arbitrary under the Fourteenth Amendment * * *." Here we are concerned only with the Fifth Amendment.³⁵

The true basis for the minority opinion, however, was "the difficulty of searching the motives and purposes of one who is dead, the proofs of which, so far as they survive, are in the control of his personal representative * * *,"³⁶ and the tremendous loss in revenue because of this difficulty, for which Justice Stone elaborately and profusely gives statistics.³⁷

It is respectfully submitted that the majority opinion is correct in its position that a death transfer tax was intended by section 302 (c) and it was therefore unconstitutional, but that the minority is on entirely sound ground in its declaration that a tax on pure gifts *inter vivos*, if enacted to remedy a serious situation, would be entirely valid. The true solution to the problem is more likely to be in a revision of section 302 (c), clearly expressing that a tax on pure gifts *inter vivos* is intended, rather than in a return to its forerunners, in view of the proven inutility of the latter.³⁸

THEODORE S. WECKER.

STATE TAXATION OF FEDERAL INSTRUMENTALITIES—FEDERAL TAXATION OF STATE INSTRUMENTALITIES.—In *McCulloch v. Maryland*, the Supreme Court declared that the constitutionally granted powers of the federal government were not subject to regulation or control by the states through the exercise of their taxing powers.¹

v. Northern Trust Co., 278 U. S. 339, 49 Sup. Ct. 123 (1928); Chase National Bank v. U. S., 278 U. S. 327, 49 Sup. Ct. 126 (1928); see Taft v. Bowers, 278 U. S. 470, 49 Sup. Ct. 199 (1928).

It is submitted that a ruling of the Supreme Court in the future to the effect that a tax is invalid if intended to embrace gifts *inter vivos* would involve overruling the above cases.

³⁵ *Supra* note 6, 52 Sup. Ct. at 365.

³⁶ *Ibid.* 52 Sup. Ct. at 367.

³⁷ *Ibid.* 52 Sup. Ct. at 367, 368.

³⁸ *Supra* note 4. Section 302 (c) has been amended by the REV. ACT OF 1932, tit. VI, §803. In part, this section reads as follows:

"Sec. 803 (a) (Section 302 (c) * * * is amended to read as follows:

"(c) * * * any transfer of a material part of his property in the nature of a final disposition or distribution thereof, made by the decedent within two years prior to his death without such consideration, shall, *unless shown to the contrary*, be deemed to have been made in contemplation of death * * *." (Italics ours.)

¹ 17 U. S. 316 (1819). See also *Osborn v. Bank of U. S.*, 22 U. S. 738 (1824); *Weston v. Charleston*, 27 U. S. 449 (1829); *Dennis v. First National Bank of Great Falls*, 55 Mont. 448, 178 Pac. 580 (1919); *Chase National Bank of New York v. Spokane County*, 125 Wash. 1, 215 Pac. 374 (1923). See also Powell, *Indirect Encroachment on Federal Authority by the Taxing Power of the States* (1919) 31 Col. L. Rev. 321.

The dual character of our American system of government demands that the powers reserved to the states be likewise exempt from the restrictions of federal taxation.²

"It is admitted that there is no express provision in the Constitution that prohibits the general government from taxing the means and the instrumentalities of the states, nor is there any prohibiting the states from taxing the means and instrumentalities of that government. In both cases the exemption rests upon necessary implication, and is upheld by the great law of self-preservation; as any government whose means are employed in conducting its operations, if subject to the control of another and distinct government, can exist only at the mercy of that government."³

The Supreme Court has often attempted to define the exact limitations upon the power of the states to tax a bank chartered by Congress.⁴ In the *McCulloch* case, Chief Justice Marshall held that the notes issued by the Bank of the United States were not taxable by the states. The Court, however, indicated that a state might validly tax the real property of the bank and the interest of citizens of the state in the institution, in common with other property of a similar character located within the state. Privately owned and controlled national banks were first established by act of Congress in 1863.⁵ The power of the federal government to regulate and maintain the currency was again invoked, as in the *McCulloch* case, to justify the establishment of these banks.⁶ A subsequent series of decisions held national banks to be subject to state taxation only when permission was specifically granted by Congress.⁷ Thus the states are now permitted to tax the real property of national banks.⁸

² See *Collector v. Day*, 78 U. S. 113 (1870); *Pollock v. Farmers Loan and Trust Co.*, 157 U. S. 429, 15 Sup. Ct. 673 (1894); *Ambrosini v. U. S.*, 187 U. S. 1, 23 Sup. Ct. 1 (1902); *Farmers and Mechanics Savings Bank v. Minnesota*, 232 U. S. 516, 34 Sup. Ct. 354 (1913).

³ *Collector v. Day*, *supra* note 2, at 127.

⁴ *Van Allen v. The Board of Assessors*, 70 U. S. 573 (1865); *Waite v. Dowley*, 94 U. S. 527 (1876); *Owensboro National Bank v. Owensboro*, 173 U. S. 664, 19 Sup. Ct. 537 (1898); *Louisville Third National Bank v. Stone*, 174 U. S. 432, 19 Sup. Ct. 759 (1898); *Junction City First National Bank v. Moon*, 102 Kan. 334, 170 Pac. 33 (1918).

⁵ For an account of the development of national banks, see CONANT, *HISTORY OF MODERN BANKS OF ISSUE* (1902) pp. 348-385.

⁶ *Veazie Bank v. Fenno*, 75 U. S. 533 (1869); *Farmers National Bank v. Dearing*, 91 U. S. 29 (1875); *Owensboro National Bank v. Owensboro*, *supra* note 4.

⁷ *Lionberger v. Rouse*, 76 U. S. 468 (1869); *Old National Bank v. State*, 58 W. Va. 559, 52 S. E. 494 (1905); *Larrabee v. Dolley*, 175 Fed. 365 (C. C. D. Kan. 1909); *Dennis v. First National Bank of Great Falls*, *supra* note 1.

⁸ U. S. REV. STAT. 5219 reads in part: "Nothing herein shall be construed to exempt the real property of associations from either state, county, or municipal taxes to the same extent according to its value as other real property is taxed."

In the absence of permissive legislation, attempts by the states to tax notes, bonds, mortgages, bills or intangible personal property held for investment have been declared unconstitutional.⁹ Nor may a state tax the franchise of a national bank.¹⁰ Shares of stock in a national bank are permitted to be taxed by the states¹¹ and thus the capital of such bank may indirectly be taxed by a levy upon the stock in the hands of the individual stockholders.¹² The federal government has also granted charters to transcontinental railroads and franchises to telegraph companies. In every case, the test of a state's right to tax such institution has been the tendency of the tax to deprive the corporation of its power to serve the national government.¹³

"It is therefore manifest that exemption of federal agencies from state taxation is dependent, not upon the nature of the agents or upon the fact that they are agents, but upon the effect of the tax, that is, upon the question whether the tax does in truth deprive them of power to serve the government as they were intended to serve it, or does hinder the efficient exercise of their power. A tax upon their property has no such necessary effect. It leaves them free to discharge the duties they have undertaken to perform. A tax upon their operations is a direct obstacle to the exercise of federal powers."¹⁴

In *Veazie Bank v. Fenno*, the Supreme Court upheld the taxation by Congress of notes issued by state banks, chiefly upon the theory that Congress in the maintenance of a sound currency may

⁹ *Rosenblatt v. Johnson*, 104 U. S. 462 (1881); *People v. National Bank*, 123 Cal. 53, 55 Pac. 685 (1898).

¹⁰ *Louisville Third National Bank v. Stone*, 174 U. S. 432, 19 Sup. Ct. 759 (1898); *Louisville v. Citizens National Bank*, 174 U. S. 436, 19 Sup. Ct. 874 (1898); *Citizens National Bank v. Burton*, 121 Ky. 876, 90 S. W. 944 (1906).

¹¹ U. S. REV. STAT. 5219 reads: "Nothing herein shall prevent the shares of any association from being included in the valuation of the personal property of the owner or holder or holder of such shares in assessing taxes imposed by authority of the state within which the association is located, but the legislature of each state may determine and direct the manner and place of taxing all the shares of national banking associations located within the state, subject only to the restriction that the taxation shall not be at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens of such state * * *."

¹² *Louisville First National Bank v. Kentucky*, 76 U. S. 353 (1869).

¹³ *Thomson v. Pacific R. R.*, 76 U. S. 579 (1869); *Railroad v. Peniston*, 85 U. S. 579 (1873); *Western Union Telegraph Co. v. Massachusetts*, 125 U. S. 530, 8 Sup. Ct. 961 (1897). See also COOLEY, TAXATION (4th ed. 1924) §§604, 605.

¹⁴ *Railroad v. Peniston*, *supra* note 13.

constitutionally restrain the circulation of notes not issued under its own authority.¹⁵

The power to borrow money is essential to the proper functioning of government. Bonds, treasury notes and other obligations of the United States are therefore exempt from taxation by the states.¹⁶ The Court has held that a state tax upon property of an individual is invalid unless United States bonds owned by him are first deducted from the assessable amount.¹⁷ Conversely, state obligations are not taxable by the federal government.¹⁸ And since a municipality is a subdivision of the state, bonds issued by a city are likewise exempt from taxation by Congress.¹⁹ However, death taxes may be imposed by either Congress or a state legislature upon the transfer by will or devise of government securities, even when the transfer is to a state or to the United States.²⁰ Such taxation is upheld on the theory that the tax is not really upon the property but only on the privilege of the testator to transmit by will or descent.

The salaries of officers of the United States are not taxable by a state²¹ and, similarly, the salaries of state officers are exempt from federal taxation.²² But incomes derived from a mere temporary or contract relationship with either government are taxable by the other.²³

¹⁵ 75 U. S. 533 (1869) at 549. "Having thus in the exercise of undisputed constitutional powers undertaken to provide a currency for the entire country, it cannot be questioned that Congress may constitutionally secure the benefit of it to the people by appropriate legislation. * * * To the same end Congress may restrain by suitable enactments the circulation as money of any notes not issued under its own authority."

¹⁶ *Weston v. Charleston*, *supra* note 1; *U. S. v. Snyder*, 149 U. S. 210, 13 Sup. Ct. 846 (1839); *North Dakota v. Hanson*, 215 U. S. 515, 30 Sup. Ct. 179 (1910).

¹⁷ In *Iowa Loan and Trust Co. v. Fairweather*, 252 Fed. 605 (D. C. S. D. Iowa 1918) at 613, the Court declared: "I cannot but feel that a tax upon the value of a share of stock, which share has its value wholly or partially because the corporation which issued the stock has purchased and holds bonds of the United States specifically exempt from taxation by the state, is contrary to the letter of the act of Congress and the spirit which underlies such enactment."

¹⁸ *Mercantile National Bank v. New York*, 121 U. S. 138, 7 Sup. Ct. 826 (1886); *Pollock v. Farmers Loan and Trust Co.*, 157 U. S. 429, 15 Sup. Ct. 673 (1894).

¹⁹ In *Pollock v. Farmers Loan and Trust Co.*, *supra* note 18, at 584, the Court declared: "The precise question as to the power of Congress to tax incomes derived from state, county and municipal bonds has never been decided, but it has often been held that the instrumentalities of the state governments cannot be directly or indirectly taxed, and, of course, a municipal corporation is but a branch of the government of the state."

²⁰ *U. S. v. Perkins*, 163 U. S. 625, 16 Sup. Ct. 1073 (1873) (state tax on bequest to federal government held valid); *Snyder v. Bettman*, 190 U. S. 249, 23 Sup. Ct. 803 (1903) (federal tax on bequest to state held valid). See also *Powell, Extra-territorial Inheritance Taxation* (1920) 20 Col. L. Rev. 1.

²¹ *Dobbins v. Commissioners of Erie*, 41 U. S. 435 (1842).

²² *Collector v. Day*, *supra* note 2.

²³ *Central Pacific R. R. v. California*, 162 U. S. 91, 16 Sup. Ct. 766 (1895); *Metcalf and Eddy v. Mitchell*, 269 U. S. 514, 46 Sup. Ct. 172 (1925).

The case of *South Carolina v. United States*²⁴ illustrates the principle that only strictly governmental activities are exempt from taxation and that Congress may tax a private enterprise in which a state has engaged. About 1900, the state of South Carolina enacted legislation providing for the sale of alcoholic beverages exclusively by the state. Swayed perhaps by the socialistic features of the experiment, the Supreme Court declared the venture to be a private enterprise and held valid a federal tax upon the agents employed by the state for the purpose.

The public lands of the United States are not taxable by a state.²⁵ And real property held in trust by the federal government for the benefit of Indian tribes is similarly exempt from taxation.²⁶ It has been held that federal property, which has been sold to a private person but the legal title to which has been retained to insure the performance of certain conditions, is not taxable by a state.²⁷ But the outright sale of public lands to private individuals immediately renders the land subject to state taxation.²⁸ The sale of an interest in federal lands, such as rights to mines upon the property, also renders the possessory estate liable to a state levy.²⁹ The courts have gone so far as to hold that where the issuance of the patent by the government is the only act remaining to vest full legal title, the equitable title of the vendee is fully taxable by the state.³⁰

The question of the taxability of state lands by Congress has been concerned chiefly with the logical value of the distinction which the Supreme Court has created between the cases of an outright sale and a lease. It has been held that the unconditional sale of property by a state to a private person renders the land immediately taxable.³¹ However, *Gillespie v. Oklahoma*³² has been regarded as establishing the rule that the income of an individual derived from lands leased from a state is not subject to a federal tax. In 1930, the case of

²⁴ 199 U. S. 437, 26 Sup. Ct. 110 (1905). See also *North Dakota v. Olson*, 33 F. (2d) 848 (C. C. A. 8th, 1929).

²⁵ *McCoon v. Scale*, 76 U. S. 23 (1868); *Van Brocklin v. Tennessee*, 117 U. S. 151, 6 Sup. Ct. 670 (1885); *Wisconsin Central R. R. Co. v. Price County*, 133 U. S. 496, 10 Sup. Ct. 341 (1890).

²⁶ *McCurdy v. U. S.*, 264 U. S. 484, 44 Sup. Ct. 345 (1923).

²⁷ *Sargeant v. Herrick*, 221 U. S. 404, 31 Sup. Ct. 574 (1911); *People v. Burke*, 204 App. Div. 557, 198 N. Y. Supp. 601 (4th Dept. 1923).

²⁸ *Union Pacific R. R. Co. v. McShane*, 89 U. S. 444 (1874); *Stryker v. Goodnow*, 123 U. S. 527, 8 Sup. Ct. 203 (1887).

²⁹ *Elder v. Wood*, 208 U. S. 226, 28 Sup. Ct. 263 (1907). In *Gillespie v. Oklahoma*, 257 U. S. 501, 42 Sup. Ct. 171 (1921) the Supreme Court declared the lessee of lands which the United States held in trust for Indian tribes to be an agent of the government for executing such trust and therefore exempt from state taxation upon his leasehold interest.

³⁰ *Bothwell v. Bingham County*, 237 U. S. 642, 35 Sup. Ct. 702 (1915); *Irwin v. Wright*, 258 U. S. 219, 42 Sup. Ct. 293 (1922).

³¹ *Gromer v. Standard Dredging Co.*, 224 U. S. 362, 32 Sup. Ct. 499 (1912); *New Brunswick v. U. S.*, 276 U. S. 547, 48 Sup. Ct. 371 (1928).

³² *Gillespie v. Oklahoma*, *supra* note 29.

*Group No. 1 Oil Co. v. Bass*³³ was brought on appeal from the Supreme Court of Texas. Statutes of that state permitted the Texas legislature to dispose of the public lands, held for the support of the state university, by sale only. The courts of Texas had so applied these statutes as to hold that a lease of such university lands constituted a present sale to the lessees of the gas and the oil in the ground. Upon appeal, the United States, in upholding a federal tax on a lessee of such lands, relied upon the ruling of the Texas courts that the lease created an outright sale, in order to preserve the decision from an obvious inconsistency with the rule in the *Gillespie* case. In its adjudication of the more recent case of *Burnet v. Coronado Oil and Gas Co.*,³⁴ a majority of the Supreme Court, in the absence of any Oklahoma statute similar to that which had determined the decision in the *Bass* case, reapplied the rule of *Gillespie v. Oklahoma* and held invalid a federal tax upon the lessee of lands owned by the state of Oklahoma. But a minority of the Court refused to be held by the doctrine of *stare decisis*. Justice Stone, dissenting, stated:

"It cannot be said that the identical tax, thus levied, has any effect on Oklahoma differing from that on Texas. The fact, if it is a fact, that under the Oklahoma leases the lessees do not acquire ownership of the oil or gas until they have severed it from the soil, but before its sale, while the lessees under the Texas lease acquire it immediately on receipt of their leases, presents no distinguishing features. All acquire private right by government grant, from the exploitation of which they have derived income which upon principles constantly reiterated by this court, * * * may be taxed as other income is taxed."³⁵

To the writer, the minority opinion in the *Burnet* case seems clearly the more tenable. First, as admitted in the prevailing opinion, the effect of the federal tax upon the state's right to control the public lands is too remote to interfere with such power to any real extent. Second, the tax is imposed upon the income derived by the lessee only after the rental price has been allocated to the state, and therefore the state's sole interest in the property during the leasehold period is in no way affected by the tax. Finally, the exemption from taxation of incomes derived from such leases can be productive only of attempts by private interests to escape the burdens of federal taxation.

JULIUS LEVENTHAL.

³³ 283 U. S. 279, 51 Sup. Ct. 432 (1931).

³⁴ *Burnet v. Coronado Oil and Gas Co.*, 52 Sup. Ct. 443 (1932).

³⁵ *Burnet v. Coronado Oil and Gas Co.*, *supra* note 34, at 446.